IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICGTION

INCOME TAX REFERENCE NO. 31 of 1990

The Commissioner of Income Tax ... Applicant.

vs.

Shri M. D. Vora ... Respondent

Mr. Ashok Kotangale, senior counsel, i/b. K.C. Sidhwa, for Applicant
Mr. Asifa Khan for Respondent.

CORAM: V. C. DAGA AND A. S. AGUIAR JJ.

Date: July 12, 2005.

ORAL JUDGMENT: (Per A. S. Aguiar J.)

1. The question of law referred to under section 256(1) of the Income-tax Act in R.A. Nos. 271(Bom)/1986 & 272(Bom)/ 1986 arising out of ITA Nos. 5510 (Bom)/1983 & 5511 (Bom)/1983) for the Assessment Years 1979-80 and 1980-81), for consideration of this court by the Tribunal at the instance of the assessee are as follows:

> Whether on the facts and in the circumstances of the case, 6% share of profit from M/s. B. Mehta & Co.,

belonged to the H.U.F. headed by M. D. Vora and 12% share belonged to M.D. Vora (Individual) for Assessment Years 1979-80 and 1980-81."

2. The factual matrix giving rise to the aforesaid question is as follows:

The assessee M. D. Vora, in his individual capacity, was a partner with 12% share in B. Mehta & Co., as per partnership deed dated 17.3.1975. Vora had contributed Rs. One lakh as capital as per clause 5 of the said partnership deed. There was a change in the constitution of the said firm due to retirement of two partners and as per partnership deed dated 10.3.1978 (effective from 1.1.1978), Vora was entitled to 18% share in the said firm and as per clause 5 of the partnership deed, he had to invest Rs.2.80 lakhs as capital. Vora claimed that the additional investment of about Rs. One lakh was made by him out of H.U.F. Funds (he was karta of the H.U.F.). Vora made a declaration on 17.11.1978 that he held 6% of share in B. Mehta & Co., on behalf of H.U.F. headed by him, after the funds belonging to the H.U.F., were invested in the firm on 1.1.1978 (from which date his share in the firm had been increased to 18% from 12%). Vora accordingly declared only his share income of 12% from B. Mehta & Co., in the accounting year ending 31.12.1978 relevant for Assessment Year 1979-80. Income Tax Officer, however held

that the unilateral declaration by Vora did not amount to an agreement and following Pondicherry Rly. Co., Ltd., 5 I.T.C. 363. The Income Tax Officer held that the assessee had only applied his income by passing 6% of share income to the H.U.F. He accordingly, assessed 18% share income from the said firm in the hands of the assessee, Vora, in Assessment Year 1979-80. He followed this order in Assessment Year 1980-81.

3. Commissioner of Income Tax, (Appeals) accepted assessee's contention after noting that the H.U.F., had declared the income from 6% share in the said firm and that the assessment of the H.U.F. had been completed accordingly. Similarly H.U.F.'s wealth tax assessments had been completed in which loan of the capital in question had been shown as advanced to M. D. Vora (Individual).

4. The Tribunal in appeal before it accepted the assessee's alternate contention that since 6% share in the firm was acquired by virtue of additional investment of capital of Rs. One lac which had been advanced out of H.U.F. funds, the 6% share income belonged to H.U.F., more so when assessee (individual) had himself declared that the said 6% share income belonged to H.U.F. The Tribunal also noted that the assessee did not rest his case on the overriding charge of the H.U.F., but took the alternative plea that since the 6%

share in the firm was acquired by virtue of additional investment of capital with the H.U.F., funds, the said 6% share in the income was relatable to the detriment to H.U.F. Funds and therefore, the said 6% share in the income belonged to the H.U.F. Moreover, the assessee himself had declared the said 6% share in the income as belonging to the H.U.F. The Tribunal in arriving at the said conclusion placed reliance on the decision in the case of **CIT vs. Mahendrakumar Mitharmal,** reported in (1983) 140 ITR 300 (Guj). In the said case a partner in the firm had impressed his share in the income of the firm with the character of Joint Family property by declaration and it was held that the said income was not assessable as the assessee's individual income.

5. Before this court reliance is placed by learned counsel appearing for the assessee on the finding of the Apex Court in the case of **Commissioner of Income Tax, West Bengal vs. Kalu Babu Lal Chand, reported in [1959] XXXVII ITR page 123.** The facts of the case are as follows:

> "R, the karta of a Hindu undivided family, was one of the promoters of a company to be floated, took over a business as a going concern and carried on the business on behalf of the company until it was

incorporated in December, 1930. The articles of association of the company provided that R would be the first managing director , specified his remuneration and required the company to enter into an agreement with R. The agreement however was not actually entered into until January, 1934. It was found by the Appellate Tribunal that the shares held in the names of R and his brother were acquired with funds belonging to the joint family and the family was in enjoyment of the dividends paid on these shares. Further, the company was floated with funds provided by the family and R made no contribution in this respect. The company was all along financed by the family. Prior to the accounting year relevant to the Assessment Year 1943-44 the managing director's remuneration received by R was credited in the books of the family. In the Assessment Year 1943-44 for the first time it was claimed that the whole of the managing director's remuneration constituted the personal earnings of R and should to be added to the income of the family.

> The Supreme Court held that the managing director's remuneration received by R was, as between him and the Hindu undivided family, the income of the family and should be assessed in its hands."

6. The learned counsel for the assessee also placed reliance on the judgment of this court in **Commissioner of Income Tax vs. M. D. Kanoria,** reported in [1982] 137 ITR p.137, wherein the facts are as under:

> "The assessee was the karta of an HUF consisting of himself, his wife and two minor sons. He had invested funds of the HUF in certain firms and was a partner in them for and on behalf of the family. There was a partial partition of the assets of the family invested in the firms, and the memoranda attached to the partition deeds contained agreements between the members that the assessee was to remain a partner in the firms but the profits falling to the share of the assessee were to be the profits of the members of the family "severally in their own respective individual right and interest" in the proportion stated in the memoranda. There were further agreements recorded in the memoranda that the share

in the profits of the firms was to be received by the assessee “for and on behalf of the members (severally)”. The ITO assessed the income received by the assessee from the firm as his income. On appeals, the AAC and the Tribunal held that the shares of the other members of the erstwhile family were diverted by overriding title and was not assessable in the hands of the assessee. The Tribunal held also that the partition did not result in the creation of a sub- partnership consisting of the assessee and his wife and, therefore , s. 64 of the I.T. Act, 1961, was not applicable. On a reference of the question whether the income of the erstwhile members of the family was diverted by overriding title, the Revenue contended that, in the alternative, the income was assessable in the hands of the assessee under the provisions of s. 64:

Held, (i) that the applicability of s. 64 was wholly independent of the question which had been referred. In any event, the Tribunal had found as a fact that the partition did not bring about any partnership. The contention that the Tribunal's finding was erroneous in

view of s. 64 could not be raised;

(ii) that the memoranda of partition expressly divided the capital standing in the name of the karta in the firms, among the members of the joint family, with the result that though the capital stood in the assessee's name in the firms' account books, that the capital was severally owned by the erstwhile members of the joint family in definite shares with a further agreement that the assessee was to receive the profits for and on behalf of the contracting parties severally. Hence, the share incomes of the assessee in the firms was subject to an overriding title in favour of the other members of the HUF in proportion to the shares allotted to them in partial partition and as such could not be taxed in the hands of the assessee."

7. Lastly, reliance has been placed upon the decision of the Allahabad High Court in the case of **Commissioner of Income Tax vs. Raja Ram Jaiswal** reported in [1992]195 ITR 834, wherein the facts are as under:

"During the assessment proceedings for the assessment

year 1970-71, the assessee raised a claim before the Income-tax Officer that he had borrowed certain amounts from two persons, namely, S and H, which amount he invested in a firm in which he was a partner. The assessee had entered into an agreement with the aforesaid two lenders some time in the year 1969, where-under he had agreed to pay the said two persons 7 per cent and 13 per cent, out of the share income received by him from the said firm. He, accordingly, claimed that the amount representing 20 per cent should not be treated as his income since that income was diverted to the lenders by an overriding title. The assessee's claim was rejected by the Income-tax Officer but accepted by the Tribunal. On a reference:

Held, that the agreements between the assessee and the said lenders were practically in the nature of sub- partnership. It was not a case where the assessee could, at any time, pay up the loans and discharge / terminate the agreements. Hence, the payments in question constituted a case of diversion of income by an overriding title."

8. In the present case the assessee has made additional investment of capital amounting to Rs.1 lac, to the firm of M/s. B. Mehta & Co., which was advanced from HUF funds. The additional share of 6% was relatable to the additional investment to the capital of B. Mehta & Co., fromd the funds of the H.U.F. The assessee who was the karta of the HUF also made a declaration that he was holding 6% share in B. Mehta & Co., on behalf of the HUF of which he was the karta. The department has not disputed that the assessee had been granted additional share of 6% in the said firm of B. Mehta & Co., after infusion of additional funds to the capital of the firm. The department has also not denied the declaration made by the assessee who is the karta to the effect that the 6% additional share in the firm was on account of the additional investment from HUF funds. There was therefore no reason for the ITO not to have accepted the contention of the assessee and to have rejected the claim of the assessee. The ITO rejected the claim solely on the ground that the declaration by the assessee being unilateral does not amount to an agreement. The existence of the declaration not being denied and the fact of HUF funds being invested in the firm of B. Mehta & Co., also not being disputed, there was no reason for the ITO to have rejected the claim of the assessee. The assessee's 6%

additional share in the income from the firm being attributable to the contribution of additional capital from the HUF funds become the share of the HUF by an overriding title of the HUF and therefore the assessee's additional 6% share in the income has to be diverted to the HUF. We accordingly answer the question referred for our opinion in the affirmative, that is, in favour of the assessee and against the Revenue. Reference disposed of with no order as to costs.

(V. C. DAGA J.)

(A. S. AGUIAR J.)

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